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COMPTROLLER GENERAL OF THE UNITED STATES

WASHINGTON, D.C. 20548

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JULY 6 1973

The Honorable Benjamin S. Rosenthal
Chairman, Subcommittee on Europe
Committee on Foreign Affairs
United States House of Representatives

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Dear Mr. Chairman:

On March 5, 1973, you requested an evaluation and update of a statistical table regarding U.S. net exchange costs for the North Atlantic Treaty Organization (NATO). You also asked for our judgment of certain effects of the 1971 and 1973 dollar devaluations on U.S. costs in NATO and foreign military purchases. In May 1973, your staff requested us to also include comments on the Department of Defense computation of the net balance of payments costs in NATO.

The following information is provided in response to your request.

NET FOREIGN EXCHANGE STATISTICS

The enclosed tables (tables 1, 2, and 3) update the 1971 estimated data you provided us on U.S. foreign exchange outlays associated with U.S. forces in Europe. These tables also contain dollar outlays and foreign military purchases that were omitted from the information you gave us.

The tables reflect a net foreign exchange cost as follows:

<u>Calendar Year</u>	<u>Cost (millions)</u>
1970	\$ 1,096.8
1971	\$ 1,014.8
1972	\$ 1,701.9

Information provided by the Department of Commerce was used to construct the enclosed tables. We were advised by Commerce officials that this information is reported quarterly to the Department of Commerce by the Department of Defense (DOD), and that figures for the last quarter of 1972 are preliminary as of March 1973.

The data on foreign military purchases, according to the Department of Commerce, represent actual deliveries of equipment and not total purchases for the years shown. The reason for this is because, for sales to most European countries, delivery is more closely associated

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with the flow of capital payments. ~~Foreign military purchases~~ generally are not paid for until delivery occurs, sometimes years later. The Federal Republic of Germany, however, does finance some of its military purchases from the United States with funds already on advance deposit with the U.S. Treasury.

The estimates contained in the table you provided indicated that amounts of military offset purchases (not deliveries) were used for its statistics, and also the table did not include data on certain other European areas.

Actual delivery figures as used in the enclosed tables would, in our view, present a more accurate net exchange outlay. In addition, our updated tables contain data on the Azores, and the countries of Austria, Yugoslavia and Sweden, since U.S. expenditures were made in those countries in connection with our present forces in Europe, and each of them also purchased military equipment from the United States.

DOD COMPUTATION OF NET ADVERSE
BALANCE OF PAYMENTS COSTS

DOD officials have stated that the net adverse balance of payments costs in NATO for both fiscal year 1972 and 1973 totalled \$400 million as compared to the over \$1 billion net U.S. foreign exchange costs you provided us for calendar year 1971. Notwithstanding the base period difference (fiscal vs. calendar years), the significant difference is that DOD considered other items as additional offsets to expenditures that could have an impact as far as the U.S. balance of payments deficit is concerned. The following schedule shows how DOD arrived at the \$400 million net adverse balance:

	(Billion)	(Billion)
A. Total Gross Department of Defense Expenditures		\$4.5
<u>Offsets to DOD Expenditures</u>		
B. Cash Receipts from NATO Military Purchases in U.S. under DOD Auspices	\$1.5	
C. Cash Receipts from NATO Military Purchases in U.S. (directly commercial)	.5	
D. Increased U.S. Exports from U.S. Expenditures in Europe	.9	
E. Purchase of U.S. Securities by Germany	.7	
F. Barter Exports Offsetting U.S. Defense Expenditures Overseas	.5	
		<u>4.1</u>
G. Net Adverse Balance from DOD Expenditures		<u>\$.4</u>

We have prepared our schedules in a manner consistent with the information you provided, and believe that the additional offsets considered by DOD to arrive at the \$400 million net deficit are questionable. Moreover, as recently pointed out on the floor of the Senate (congressional record - June 8, 1973), DOD has stated a \$1.5 billion annual adverse balance of payments cost in NATO, as compared with a \$400 million deficit previously cited for a 2-year period.

For an explanation of the offset items previously cited by DOD we are enclosing notes to a DOD data sheet which was prepared to describe them. As indicated, we believe the use of some items for offset is questionable. Our analysis of these follows.

Cash receipts from NATO military purchases
in the United States under DOD auspices

DOD indicated that actual cash receipts were not used for this amount and that the amount of the current offset agreement with Germany for military purchases represents most of this offset. The remaining portion of the offset is comprised of cash receipts from other NATO allies with the fiscal year 1973 amount based on an assumption that the level will be the same as fiscal year 1972.

Germany finances about \$.5 billion of its agreed purchases with funds already deposited in the United States, and the timing of the actual balance of payments impact of the deposit appears questionable. We believe deliveries or actual cash receipts are more accurate measures of balance of payments impact.

Cash receipts from NATO
commercial military purchases

About 60 percent of this DOD offset, \$300 million, represents Germany's scheduled commercial purchases and the remainder includes commercial purchases of other NATO countries. DOD assumes it has exercised a demonstrable influence resulting in these other commercial exports. However, it is possible that a significant amount of these purchases would be made regardless of DOD influence overseas. For example, France continued to purchase military items from U.S. manufacturers without substantial U.S. defense expenditures there.

Increased U.S. exports (feedback)

As explained in the enclosed DOD notes on the data sheet entitled "Department of Defense - Balance of Payments Impact NATO - FYs 1972-1973", DOD assumes a 20 percent German feedback factor which it uses as an offset. As the basis for the feedback, a 1967 study indicated that there was a 19.5 percent return, but this was based on the assumption that U.S. expenditures in Germany were not needed. The study was based upon data prior to 1967.

DOD also attributes the 20 percent feedback to all other U.S. military expenditures in NATO Europe. DOD officials could not provide any further documented basis for the feedback offset.

An authority on international economics, while testifying before Congress, expressed the opinion that U.S. defense expenditures create a consequent feedback effect on underdeveloped areas but he said this is not true for developed areas.

We also question the basis for this offset item, its applicability for developed European countries, and while some degree of feedback may be realized, we do not believe the underlying assumptions justify claiming a 20 percent return.

Purchase of U.S. securities by Germany

Although DOD recognizes that securities must also be repaid, DOD has not included as an added expenditure about \$635 million of securities redeemed by Germany during the same period. DOD officials indicated that only the fiscal year 1972-1973 German offset agreement terms were considered regarding the purchased securities and that redemption of previously purchased securities was not considered.

The inclusion of the purchase of securities as an offset when excluding the redemption of securities gives a misleading picture of the true balance of payments impact for the period indicated. We believe the redemption expense should be set against the purchase offset to arrive at a fair balance of payments impact.

Barter export offsets

The term "barter" is a misnomer for this program as actual barter of commodities is no longer done. DOD feels justified in using this offset since it has the largest level of expenditures overseas and therefore would be the most logical agency giving incentive to the program.

Although this program has had a positive balance of payments impact for the United States, the basis for DOD taking the offset is vague. Agricultural commodities could be sold overseas regardless of the expenditures by DOD. Furthermore, on May 31, 1973, the barter program was suspended by the Department of Agriculture due to the strong demand for U.S. commodities making the export incentives of the program unnecessary.

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ANALYSIS OF CALENDAR YEAR
1971 AND 3-YEAR TREND

The enclosed table for 1971 net exchange outlays shows about a \$265 million lower total outlay than in the estimated table which you provided. In our view this difference is accounted for because the table:

- contained estimated statistics,
- omitted data on certain European countries, and
- used an offset purchase figure for Germany which was about \$144 million less than actual deliveries shown on Department of Commerce records.

In order to present a trend analysis for all 3 years, we have incorporated each foreign exchange category into one table (table 4). This table shows that the U.S. foreign exchange expenditures have considerably increased in the majority of the countries. Against this is offset the cost of foreign purchases of U.S. military equipment deliveries. The total figure, largely due to German purchases, increased in 1971, but in most cases the figures decreased individually by country in 1972 and substantially decreased in total.

The table reflects a net U.S. exchange cost increase in almost every country to the total 1972 level of about \$1.7 billion.

DEVALUATION IMPACT ON U.S.
PARTICIPATION IN NATO

As a result of the 1971 and 1973 devaluations of the dollar, DOD costs for programs in NATO countries have increased.

DOD assembled data concerning the worldwide budgetary impact of these devaluations in terms of the added costs of purchasing foreign currencies with U.S. dollars. This information indicates the following DOD major losses on the dollar devaluations:

	<u>Totals</u>	<u>FY 1972</u>	<u>FY 1973</u>	<u>FY 1974</u>
		(millions)		
1971 devaluation	\$ 295.8	\$ 134.5	\$ 161.3	\$ -
1973 devaluation	<u>327.3</u>	-	114.0	<u>212.7</u>
Total	\$ 623.1	\$ 134.5	\$ 275.3	\$ 212.7

These budgetary figures do not include increased personal spending of overseas personnel, except station allowances and per diem, which could conceivably increase the overall balance of payments loss by an estimated \$140 million on the 1973 devaluation above.

Of the total worldwide budgetary impact shown above, approximately \$119.1 million is estimated by DOD to be related to revaluation of the Japanese yen currencies (including Okinawa). Also, about \$60 million is associated with DOD petroleum, oil, and lubricant procurement overseas, about half of which is estimated to be purchased in Europe.

Using the DOD estimates to summarize the total impact on U.S. participation in NATO, a rough calculation would indicate a total devaluation loss of about \$600 million.

DEVALUATION IMPACT ON FOREIGN
MILITARY PURCHASES

The Foreign Military Sales Act requires foreign purchasers of U.S. military equipment to pay for the equipment in U.S. dollars. Also, military sales contracts do not contain a devaluation clause. Therefore, the recent devaluations of the dollar in foreign currency markets, particularly Europe, do not directly impact on the number of dollars paid for U.S. defense articles and services. This means that DOD accepts the same dollar amount of cost value for military equipment and services even though the dollar is devalued in terms of the purchasing country's local currency.

Because of the dollar devaluation foreign currencies can be exchanged for more dollars. This can lead to greater foreign purchases of goods from the United States.

We hope this information will provide you with the background you requested.

Sincerely yours,

PAUL G. DEMBLING

Acting Comptroller General
of the United States

Enclosures - 2

FOREIGN EXCHANGE OUTLAYS ASSOCIATED
WITH U.S. FORCES IN EUROPE
CALENDAR YEAR 1970
(millions of dollars)

Category	Germany	United Kingdom	Italy	Netherlands	Denmark	Belgium	Norway	Sub-Total	Other NATO	Other West Europe	Total
Defense expenditures	225.9	120.2	47.3	27.9	24.7	13.7	3.5	769.2	43.6	37.5	850.4
Defense personnel	107.6	90.3	49.7	12.5	4.0	20.4	2.4	725.9	26.0	50.1	802.0
Defense services	1,053.5	225.5	97.0	40.4	23.7	34.1	5.9	1,495.1	69.6	87.6	1,693.0
Defense expenditures	107.6	90.3	49.7	12.5	4.0	20.4	2.4	725.9	26.0	50.1	802.0
Defense personnel	1,053.5	225.5	97.0	40.4	23.7	34.1	5.9	1,495.1	69.6	87.6	1,693.0
Defense services	107.6	90.3	49.7	12.5	4.0	20.4	2.4	725.9	26.0	50.1	802.0
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Defense expenditures	107.6	90.3	49.7	12.5	4.0	20.4	2.4	725.9	26.0	50.1	802.0</

Source: Department of Commerce - Bureau of Economic Analysis. This information made available to Commerce by DOD under a transaction 70C0.2 (figures were rounded).

Other countries: Greece, Turkey, and Portugal (Azores).
 France, Spain, Poland, Austria, Yugoslavia, and Sweden.
 Included, U.S. share of NATO infrastructure expenditures, offset by NATO purchases.
 Excludes military equipment exceed U.S. expenditures in Norway.

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Table 2

FOREIGN EXCHANGE OUTLAYS ASSOCIATED
WITH U.S. FORCES IN EUROPE
CALENDAR YEAR 1971
(millions of dollars)

Category of U.S. Foreign Exchange Expenditure	Germany	United Kingdom	Italy	Nether- lands	Denmark	Belgium	Norway	Sub- Total	Other NATO	Other West Europe	Unallo- cated	TOTAL
Personnel and equipment	620.6	147.0	56.5	35.5	25.3	12.6	4.8	902.3	36.4	40.9	62.1	1,032.7
Food and military supplies	516.5	104.3	50.8	14.6	7.0	23.4	2.6	819.2	27.5	63.0	--	909.7
Medical and dental services	1,237.1	251.3	107.3	50.1	32.3	36.0	7.4	1,721.5	65.9	103.9	62.1	1,953.4
Construction	594.1	104.5	60.5	11.6	10.3	12.1	13.7	806.8	35.7	64.7	31.4	938.6
Transportation	273.0	146.8	46.8	38.5	22.0	23.9	(6.3) ^{U/}	514.7	30.2	39.2	30.7	1,014.8

Source and footnotes: See table 1.

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ENCLOSURE 1

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See Table 1.

ENCLOSURE 1

Table 4

FOREIGN EXCHANGE OUTLAYS ASSOCIATED
WITH U.S. FORCES IN EUROPE
CALENDAR YEARS 1970-1971-1972
(millions of dollars)

Years	U.S. Foreign Exchange Expenditure Associated with U.S. Forces Stationed in Europe			Foreign Purchases of U.S. Military Equipment (deliveries)			Net U.S. Foreign Exchange Costs		
	1970	1971	1972	1970	1971	1972	1970	1971	1972
Germany	1,063.5	1,237.1	1,330.0	193.9	594.1	212.1	869.6	643.0	1,117.9
United Kingdom	225.5	251.3	328.7	175.0	104.5	55.4	50.5	146.8	273.3
France	97.0	107.3	125.5	48.5	60.5	35.7	48.5	46.8	89.8
Netherlands	40.4	50.1	51.7	9.7	11.6	15.5	30.7	38.5	36.2
Belgium	28.7	32.3	30.2	8.6	10.3	11.4	20.1	22.0	18.8
Denmark	34.1	36.0	43.7	9.8	12.1	7.3	24.3	23.9	36.4
Sweden	5.9	7.4	7.8	28.7	13.7	15.3	D/(22.8)	(6.3)	(7.5)
Portugal	69.6	65.9	63.9	26.7	35.7	28.3	42.9	30.2	35.6
Other W. Europe ^{B/}	87.6	103.9	113.2	61.9	64.7	64.3	25.7	39.2	48.9
Unallocated ^{C/}	40.7	62.1	67.1	33.4	31.4	14.6	7.3	30.7	52.5
TOTALS	1,543.0	1,953.4	2,161.8	596.2	938.6	459.9	1,096.8	1,014.8	1,701.9

Source and footnotes: See table 1.

Notes on Data Sheet Entitled,
"Department of Defense - Balance of Payments Impact
NATO - FYs 1972-1973"

A. Total Gross Department of Defense Expenditures - \$4.5 billion - Gross U.S. Defense expenditures entering the balance of payments in NATO Europe in FY 1972 were approximately \$2.1 billion and are currently estimated at somewhat less than \$2.4 billion in FY 1973. Total for the two years taken together is \$4.5 billion.

B. Cash Receipts from NATO Purchases in U.S. under DoD Auspices - \$1.5 billion - Includes \$.9 billion under U.S. FRG offset arrangements and \$.6 billion from other NATO countries. Under current U.S. FRG offset arrangements covering FY 1972-73, German military purchases are scheduled at about \$1.2 billion. Of the \$1.2 billion, approximately \$.9 billion is assumed to be under DoD auspices and \$.3 billion in receipts from purchases directly through U.S. commercial channels. Cash receipts from other NATO allies were \$.3 billion in FY 1972 and are assumed to remain at that level in FY 1973. Our standard footnote on receipts is:

Cash receipts data include (1) sales of military items through the U.S. Department of Defense; (2) sales of services and excess personal property; and (3) receipts for military equipment procured through private U.S. sources where covered by government-to-government agreements, e.g., with the Federal Republic of Germany. Excludes financial arrangements, e.g., sale and redemption of medium term U.S. securities with the FRG.

C. Cash Receipts from NATO Military Purchases in U.S. (direct commercial) - \$.5 billion - This \$.5 billion includes \$.3 billion direct commercial purchases by the FRG in the U.S. during FY 1972-73. An additional \$.2 billion is assumed during FY 1972-73 (\$.1 billion per year) for commercial purchases by other NATO countries directly from U.S. suppliers.

D. Increased U.S. Exports from U.S. Expenditures in Europe - \$.9 billion - Since about FY 1968 under U.S.-FRG offset arrangements, the FRG generally has been given credit for a 20% "feedback" effect. This assumes that the equivalent of 20% of U.S. military spending in the FRG returns to the U.S. in other accounts, i.e., serves to increase U.S. commercial exports. The \$.9 billion reflects 20% of the gross expenditure estimate of \$4.5 billion in NATO Europe.

E. Purchase of U.S. Securities by FRG - \$.7 billion - Current U.S. FRG offset arrangements include German purchases of U.S. securities of more than \$.6 billion, and in addition the equivalent of the interest on the loan is added as a separate offset entry. Together, these are shown at \$.7 billion. It is recognized that such loans must be repaid: this loan or credit is repayable after 4-1/2 years

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F. Barter Exports Offsetting U.S. Defense Expenditures Overseas - \$1.5 billion - DoD "receipts" associated with barter exports reached approximately \$1.9 billion in FY 1972 and are assumed to remain at about that level in FY 1973. About \$250 million each year is associated with U.S. requirements in NATO Europe. Barter procedures work about as follows: DoD notifies the Department of Agriculture it has requirements susceptible to barter requirements; i.e., fresh milk procurements in Germany. Agriculture notifies U.S. barter brokers of requirements, sells wheat or other commodities authorized for disposal to U.S. barter broker offering lowest disposal fee; the broker sells commodities in authorized locations outside the U.S., and the broker deposits the stipulated amount in special DoD accounts. From these accounts DoD pays suppliers. DoD sends a Treasury check to Department of Agriculture in a like amount covering the barter broker's obligation. This procedure prevents additional dollars from entering the balance of payments.

G. Net Adverse Balance from DoD NATO Actions - \$1.4 billion - Gross receipts less offsets.

H. Overall FY 1972 U.S. Adverse Balance of Payments from all Accounts - Official Settlements - \$22.0 billion -

Source: Department of Commerce publication, Survey of Current Business, December 1972, page 41, line 42.

OASD(Comptroller)
March 28, 1973